

General Information Letter: Request to use separate accounting not granted absent showing of distortion by usual apportionment formula and accuracy of separate accounting.

January 12, 1999

Dear:

This is in response to your letter dated July 24, 1998, in which you request permission to use an alternative method of allocation or apportionment. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding against the Department, but only as to the taxpayer who is the subject to the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of Department policy that apply, interpret or prescribe the tax laws and are not binding against the Department. See 2 Ill. Adm. Code 100.1200(b) and (c).

Although a ruling granting an alternative allocation or apportionment has been requested, since the petition fails to sustain the burden of proof required pursuant to 86 Ill. Adm. Code 100.3390 (copy enclosed) the Department must respond by GIL denying the petition.

In your letter you have stated as follows:

This is a request for a special apportionment method to be determined for the above mentioned taxpayer.

xxxxxxxx xxxxxxxx xxxxxxxxxxxx has three store locations:

xxxxxx, Missouri

xxxxxxxx, Missouri

xxxxxxxxxxxx, Illinois

Each store maintains separate accounting books which reflect income and expenses for that location only. Income and expenses are not commingled among the locations.

Using the apportionment method on the Form 1120-ST greatly overstates Illinois income by more than 20 times the actual income derived and earned in the State of Illinois

Illinois income based on this apportionment 47168

Illinois income based on accounting books 2189

---

Overstatement of Illinois income 44,979

We request that xxxxxxxx xxxxxxxx xxxxxxxxxxxx be allowed to use an apportionment method that would more accurately reflect Illinois based income. We would like to use a method which would actually allow the corporation to report actual earnings in the State of Illinois as these amounts can be readily ascertained from their accounting records.

We request that this apportionment method be retroactive to January 1, 1997, so that an amended return can be filed for the year ended December 31, 1997 showing correct Illinois based income and a refund of the overpayment of these taxes can be refunded to the corporation.

### RULING

Where the activities of a taxpayer in Illinois form part of a unitary business that extends into other states, the Illinois Income Tax Act (the "IITA"; 35 ILCS 5/101 et seq.) requires that the income generated by those activities be apportioned under a three-factor formula (IITA §304(a)). This formula compares the taxpayer's Illinois and aggregate property, payroll, and sales (See Id.). Illinois rejects the separate or geographical accounting method in such circumstances since that method ignores or captures inadequately the many subtle and unquantifiable transfers of value that take place among the components of a single enterprise (Container Corporation of America v. Franchise Tax Board, 463 U.S. 159, 164-65, 103 S.Ct. 2933, 2940 (1983)). Thus, the formula apportionment method is used, which focuses upon objective measures of a taxpayer's activities within and without the state (Id.)

At the same time, formula apportionment may not be applied without exception. The factors used in the apportionment formula must actually reflect, in each individual case, a reasonable sense of how income is generated (Id. at 2942). And where the apportionment formula does not so reflect, a fair and accurate alternative method is appropriate (86 Ill. Adm. Code 100.3390(c)). Accordingly, IITA section 304(f) allows the taxpayer to petition the Director for an alternative apportionment method, including separate accounting, where the statutory method does not fairly represent the extent of the person's business activity in Illinois.

Consistent with these principles, Illinois Income Tax Regulations section 100.3390(c) sets forth the taxpayer's burden under section 304(f) as follows:

A departure from the required apportionment method is allowed only where such methods do not accurately and fairly reflect business activity in Illinois. An alternative apportionment method may not be invoked ... merely because it reaches a different apportionment percentage than the required statutory formula. The party ... has the burden of going forward with the evidence and proving by clear and cogent evidence that the statutory formula results in the taxation of extraterritorial values and operates unreasonably and arbitrarily in attributing to Illinois a percentage of income which is out of all proportion to the business transacted in the state. In addition the party ... must go forward with the evidence and prove that the proposed alternative apportionment method fairly and accurately apportions income to Illinois based upon business activity in this State.

Regulations section 100.3390(d) adds:

A petition will be summarily rejected if its sole basis for support rests on the fact that an alternative method reaches a different apportionment percentage than the required statutory formula.

These provisions indicate the taxpayer's burden under IITA section 304(f) to be two-fold. It must be shown not only that the alternative method proposed results in a fair allocation, but also that application of the statutory method results

in an unfair allocation. Moreover, because separate or geographical accounting does not fully reflect the value-producing factors of a unitary business, the second aspect of the taxpayer's burden is not satisfied merely by showing that separate or geographical accounting results in an allocation that differs from the statutory method. Thus, a petition supported solely by the allocation arrived at under the separate or geographical accounting method must be rejected since it fails to reveal any defect or unfairness in applying the factors relied upon by the apportionment formula to approximate where business income has been derived.

In this case, the petition contains as its sole support an allocation under the separate or geographical accounting method that differs from the allocation arrived at by application of the three-factor apportionment formula. The petition argues only that the formula method overstates Illinois income while the separate or geographical accounting accurately reflects Illinois income. Hence, the petition must be rejected pursuant to Illinois Regulations section 100.3390(d).

As stated above, this is a GIL which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department.

Sincerely,

Paul Caselton  
Associate Chief Counsel - Income Tax